DOW THEORY LETTERS INC.

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Registered with the Securities Exchange Commission

40 Letters per Year — $50.00 Annually

April 1, 1965 Letter 284

THE MARKET: In recent Letters I have drawn attention to the strange divergent action of the Averages. The two indicators (Industrials and Rails) recorded their last joint highs on October 20 — five months ago. In order for the bull market to be reconfirmed, Industrials will have to better their February high of 906.30 (see Chart 1) and Rails will have to push above their October high of 224.91. Conversely, a retreat by the two Averages below their December lows (857.45 and 203.51) will mean that the entire movement since October was the first part of a bear market. I have stressed, however, that under Dow Theory a trend is taken to remain in force until proved otherwise. This means that we are classifying the primary trend as bullish (and it will remain bullish as long as one or both Averages hold above the December lows).

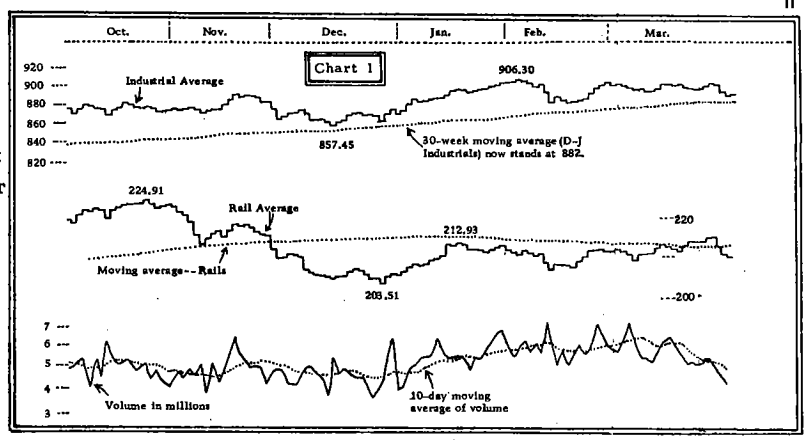
From the secondary standpoint, note that Industrials have traced a series of declining peaks — 906.30 on February 10; 903.48 on February 20; 900.56 on March 24. Against this, Rails on March 25 rallied to a 1965 high of 215.98 (which was still 9 points below their 1964 bull market high, however). The March 25 Rail high was immediately followed by last week's sharp sell-off.

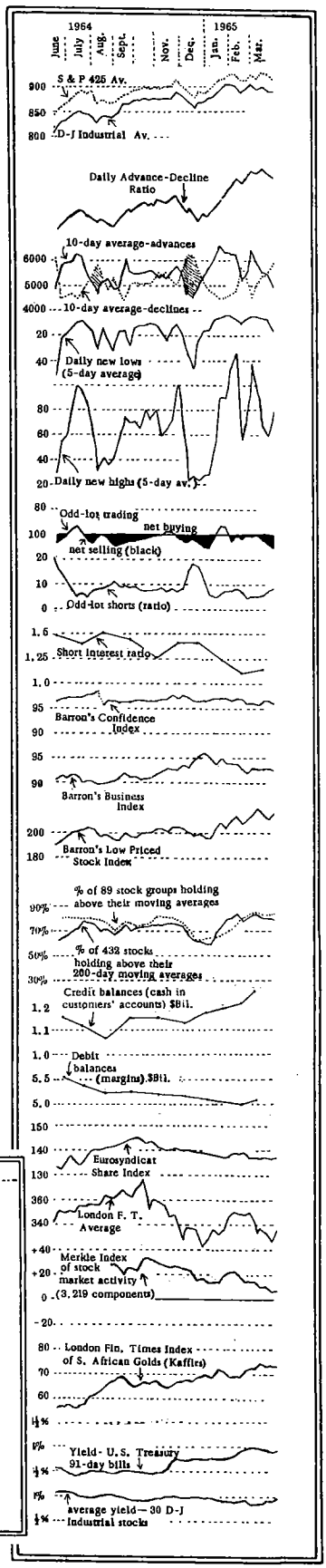
Conclusion: A break below the February lows of 881.88 and 207.09 would look serious, but the December lows remain the critical ones. In the meantime, the market appears to be drifting in a state of "confused watchfulness." It is a tricky market, and it will not be hurried. Veterans will do well to sit back and wait for the two Averages to tell their story — a push by both Averages to new highs, or a retreat below the December lows.

The Composite Chart shows selling pressure coming into the market as the 10-day average of declines rises above advances. Daily highs and lows are on the new 1965 basis and will not be significant for a while. Odd-lot transactions continue heavily on the selling side, a constructive phenomenon. The percentage of stocks and groups holding above their moving averages is still above 80% — a positive indication. The Eurosyndicat Index composed of the 100 largest Common Market companies continues in its sideways but unimpressive rut as the world mulls over the possibility (or probability) of British devaluation. London is in a rallying phase, but the overall picture there is still bearish. The Kaffirs gold index remains outstandingly strong and near its 1965 high. The yield on the 91-day Treasury bills is still 1% higher than the yield on the D-J Industrial Average, and this "freakish" (from the standpoint of history) relationship continues to bespeak of long-term danger. GENERAL CONCLUSION: The indicators present a "mixed bag" and are not predominantly bullish or bearish. Dow's classic Theory, in my opinion, gains in significance as many technical indicators lapse into confused cross-currents.

STOCK SELECTION: From time to time I have written about the gathering "army of technicians" who are now engaged in the Wall Street game. If any further proof is needed, simply go to your library and check a copy or two of Barron's from the early 1950's or before — then compare it with a current issue. Count the number of technical and chart services in each. You will be amazed by the comparison.

All this has made for increasing difficulty in picking stocks. Stocks that "act well" are now apt to gather a large following before they ever "get off the ground." What can the market analyst do about it? My answer has been to do more work and demand more "tests" than ever before. This procedure was discussed in Letter 264 and more recently in Letter 281. The whole discussion seemed "to ring a bell" with readers. Many want more information and specific examples as well.

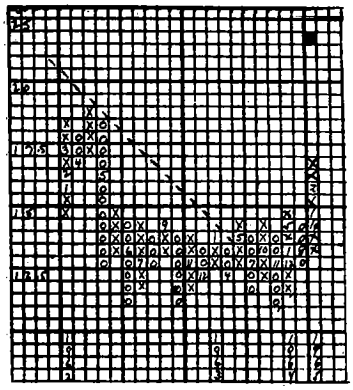



1964
1965
S & P 425 Av.
D-J Industrial Av.
Daily Advance-Decline Ratio
10-day average-advances
10-day average-declines
Daily new lows (5-day average)
Daily new highs (5-day av.)
Odd-lot trading
net buying
net selling (black)
Odd-lot shorts (ratio)
Short Interest ratio
Barron's Confidence Index
Barron's Business Index
Barron's Low Priced Stock Index
% of 89 stock groups holding above their moving averages
% of 432 stocks holding above their 200-day moving averages
Credit balances (cash in customers' accounts) $Bil.
Debit balances (margins) $Bil.
Eurosyndicat Share Index
London F. T. Average
Merkle Index of stock market activity (3,219 components)
London Fin. Times Index of S. African Golds (Kaffirs)
Yield - U. S. Treasury 91-day bills
average yield — 30 D-J Industrial stocks

In Letter 282 I presented readers with only one N.Y.S.E. selection. That stock was Baldwin-Lima-Hamilton, which was then selling around 16. At this stage of the bull market, I do not recommend stocks lightly. Any stock recommended here must intrigue me from a good many angles; if not, I would rather not bring it to the attention of readers at all. Baldwin (B) is an interesting stock, and it is worth discussing from the standpoint of both general stock selection and from the standpoint of its own particular merits. B is in the Rail Equipment group, a group which has been acting well on a relative strength (R.S.) basis.

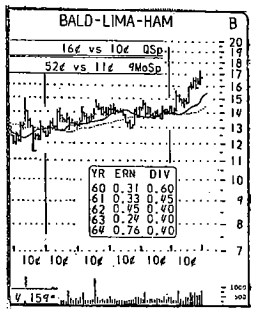
Earnings for B have been improving, the latest full year report showing 76¢ against 24¢ last year (yr. ending Dec.). B is now selling at a 40% discount from its stated asset value ($25.70), and it is actually selling around its net current assets of about $17.80. B has no senior debt or bonds so that all earnings go to the 4 million common shares. In December the outstanding Dreyfus Fund added 14 thousand shares of B to its portfolio, boosting total holdings to 95 thousand. During November to February insiders bought 3800 shares of B. The company itself purchased $1 million worth of its own stock during 1964, thus increasing share value by decreasing total number of outstanding shares (and this process is expected to continue).

BALDWIN-LIMA-HAMILTON (B)

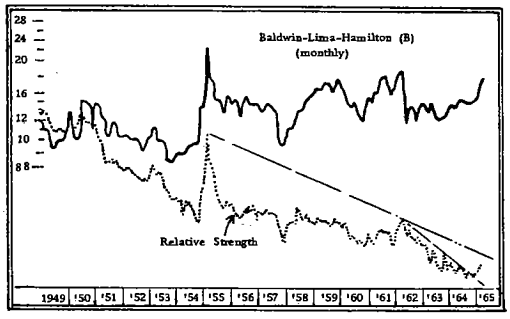


The point & figure chart shows a beautiful extended base for B going back to 1962. During 1964 and 1965 (see P & F chart) B moved sideways through an "inhibiting" descending trendline, which was technically a good sign. During February B pushed decisively above its entire base structure. This size of the base can be gauged by taking a P & F "count." If we count the squares (horizontally) across B's base we note that there are 18 squares, each one representing ½ point (or 9 full points). This would allow for an approximate 9 point rise from the point of "breakout" which was 15. The theoretical "price objective" is therefore around 24. B may never see 24, but as an analyst I find it conforting to know that this stock has traced out a base which technically "allows" for such a rise. It simply means that the odds are much further in favor of the buyer of B.

Next turn to the small weekly chart and note that volume is tending to build up as B pushes out. Also note that B is now above its 10-week moving average line, and that the 10-week line is in turn above the 200-day moving average line (dotted line on chart). B is not too far above the 200-day line. Under my 30% rule, when a stock pushes 30% or more above its 200-day line it is ready for a correction. This means that B can rise to around the 20 area before it is due for a rest (obviously, this does not guarantee that B will go to 20, it merely means that it can go to 20 in one sweep without violating a technical "rule").

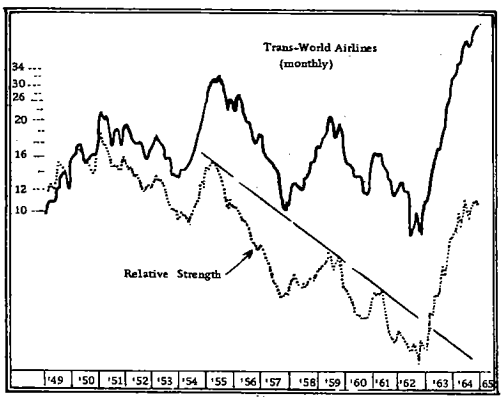


Finally, and this is one of the things that intrigues me about Baldwin, the stock is turning up from an area which represents its lowest R. S. level (see Chart) in a generation. What does the massive collapse in B's R. S. line mean? For one thing, it means that all the people who have held this stock over the past twenty years are now thoroughly disgusted with it. They have watched this stock "do nothing" for decades, and this suggests that three catagories of people hold B now: (1) "Diehards" who never gave up in their faith that B would come back. (2) Fools who should have sold it long ago but didn't. (3) Intelligent investors who believe that B may now be making a turn for the better. As such, they are buying it now.



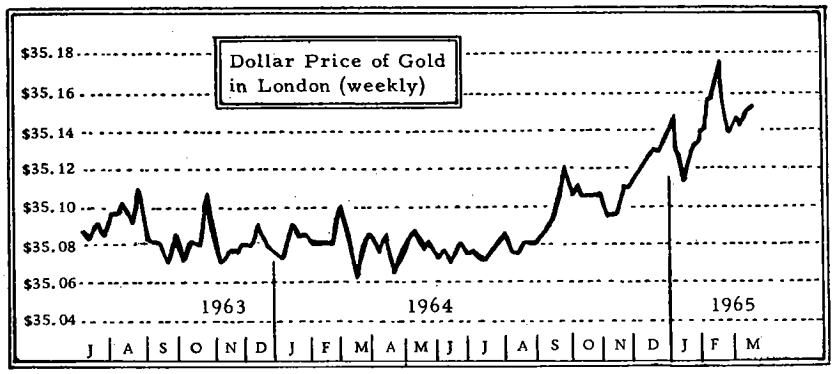
The question might be asked: "How do we know that the third catagory exists at all?" The answer is that we cannot be absolutely sure, but that charts show B holding in the 11 to 15 area all during 1962, 1963 and 1964. Lately it has pushed out to its highest level since 1961. Is this a true turnaround, or is it another deceptive bear rally? We can only guess, but it is a fact that earnings for B are on the increase, the technical base is huge and the breakout has occurred.

But here is the point. If this is to be a move, it is occurring from an extraordinary extreme of "unpopularity" as shown by the R. S. line. Baldwin is "sold-out," people are disgusted with it, holders of B over the past twenty years wish they had never heard of it. From such sold-out situations many great rises have occurred.



I offer the chart of Trans-World Airlines for comparison purposes (no prediction regarding future price action in Baldwin is implied). What this chart does show is that the unbelievable explosion in TWA materialized from a prior extended collapse in TWA's relative strength or market popularity. When the fundamental turn came, nobody wanted the stock or believed in the turn. In other words, many of the greatest rises are apt to occur in stocks which are extremely unpopular but which are actually turning as far as fundamentals are concerned. Conversely, if a group is very popular, if the "good news" is well known and the stock is already "up," the percentage of rise is going to be limited. I list the Auto stocks in this catagory.

All market analysis boils down to probabilities. Therefore, if I had to make a guess as to whether General Motors or Baldwin were capable of rising say 50% from here, I would pick Baldwin. And that is not a prediction, it is an exercise in probabilities.



PROTECTION: Perhaps the greatest worry in the minds of investors today is protection of their buying power. What happens if inflation becomes rampant? What happens if Britain (and then perhaps the U. S. or all countries) devalue? What should one's investment policy be in the face of world fear of inflation, in the face of unabated American inflation and in the face of a weakening European boom?

The accompanying chart is not a "theory" or an "opinion," it is literally a gauge of the speculative sentiment for or against the dollar. Since the dollar is actually defined in terms of a specific amount of gold, it is obvious that a rising trend in the price of gold (in terms of dollars) is nothing more than speculation against the value of the dollar. The chart shows what has been happening to the price of gold over the past two years. Against a stable performance during late 1963 and the first half of 1964, the price of gold has been steadily rising during late 1964 and 1965. Demand for gold is rising because of purchases by foreign governments, by individuals (who are hoarding it in huge quantities) and even by overseas corporations. According to monetary expert Franz Pick, gold is now in such short supply that bullion dealers and Swiss banks are refusing to sell gold for six months delivery (because they are not sure they can deliver).

Most investors harbor vague worries concerning inflation and devaluation. The two are not necessarily connected. The last time the U. S. devalued was in 1934 — during the Great Depression. Inflation was no factor then, and people were not the least bit worried about the buying power of the dollar (they were more worried about how to earn a few dollars); the cost of living remained stable, and no overnight inflationary wave was caused by the rise in the price of gold from $20 to $35 an ounce.

It could be a different story today. Most of the governments of the Western world would be profoundly shaken (and many would topple) in the face of severe deflation. Consequently, the politicians could (in the event of deflation) be expected to call for heavy government spending and planned inflation. But in order to do that, they would almost certainly need a larger monetary reserve, or in other words, a larger gold base (and this is particularly true in view of the current increasing emphasis on gold by European central bankers). What will the final outcome be? In my opinion, it could be an "agreed" multilateral rise in the price of gold so that the world gold base could be substantially increased. Furthermore, if dollars continue to be recalled from Europe as per the new Johnson plan for correcting our balance-of-payments, Europeans will be even more pressed to create a new currency based on gold, a currency with a gold base large enough so that the European economy can be kept in motion.

The above would be the "organized" (or should we call it the "pleasant") aspect of devaluation. But what if the British pound collapses, and Britain decides on unilateral devaluation? There is no doubt that the pound is now weak, and it is continuing weak. Britain's $3 billion loan (to bolster the pound) comes up for renewal in May. The European nations who provided the loan are unlikely to renew, or if they do it is certain that they will impose even tougher deflationary demands on Britain. The odds are that the Labor Government will not accept stiffer deflationary policies. The alternative will then be devaluation of the pound.

Britain's dwindling reserves are undoubtedly being used continuously in an attempt to support the pound. If Britain "tosses in the towel" and devalues, we could have chaos for months as other dependent nations adjust their own currencies to a devalued pound and as competing nations decide whether to protect themselves by devaluing their own currencies. Finally, if Britain devalues pressure will immediately build up against the other reserve currency — the dollar. Will Britain devalue? In my opinion, there is a very good chance of it.

But as far as I am concerned, one of the crucial questions is being neglected by almost every investor and economist. That is — if devaluation comes, will it arrive during a bull or a bear market? If it comes during the current bull market we could witness a final flare-up of inflation, but I believe this would leave most people "hedged" up to their necks against inflation at precisely the wrong time — at a time when a major bear market was just around the corner (the approaching bear market is, of course, my own personal opinion). On the other hand, if a bear market arrives and devaluation follows (the price of gold might be raised in an effort to "get the boom going again"), I believe such an effort would fail miserably. I believe this because I know the way primary bear markets work. Then the tide turns down, manipulation, devaluation, work projects, inflation schemes, Presidential edicts, all these are as chaff in the wind. For just as the parade of major scares since 1949 (for instance, Korea, Sputnik, Eisenhower heart attack, Suez) could not stop the progress of the primary bull trend, neither will devaluation nor anything else stop a primary bear market. Booms are built on credit and confidence. When a bear market strikes, both of these factors disintegrate.

What is the answer for the poor investor? He can buy common stocks, gold shares or even hedge by purchasing French or Swiss francs or German marks (which might hold steady against say a British or U. S. devaluation). He can hold real estate or land (both of which are, in my opinion, far too non-liquid from this point on). But I believe the best bet is a position in S. African golds, a large cash position (Treasury bills), and perhaps a 10 to 20% position in common stocks. If the boom continues, the investor will probably show profits in his golds (many of the S. African golds are "growth" stocks in terms of earnings), and he may be lucky enough to show profits in some of his common stocks. If devaluation comes during the bull market, his gold will protect him.

On the other hand, if the market "tops out" and a bear market begins, the common stock can be sold immediately and only the cash and golds held. In the event of devaluation during the bear market, the golds will still be a valid hedge. Furthermore, as the bear market progresses, the cash position will increase in value (i.e., purchasing power). This is the way I see it, this is the way I have "played" it myself. If I can come up with a better plan, my readers will be the first to learn about it.

STOCKS: I have been recommending the purchase of S. African gold shares (Kaffirs) for a long time. The largest part of Letter 276 was devoted to a discussion of the case for the Kaffirs, and I noted at that time that S. Africa was "out of favor" with investors who believed that owning securities there entailed a great risk. I stated that "it is my contention that as interest focuses increasingly on gold, there will be more study of the entire situation and a gradual realization that S. Africa is actually a safer and more stable nation than most investors realize."

The "news" about S. Africa is now beginning to emerge as I expected it would. I want subscribers to understand that I have strongly recommended the Kaffirs up to 15% of holdings. This was investment advice; it had nothing to do with my political or social views.

The Kaffirs are going to be traded whether we agree with the racial policy of apartheid or not, and when I present evidence in favor of S. Africa, I am doing it as an investment advisor, not a latter-day Thomas Paine. In the current (Mar. 27) issue of the London Economist there is a feature article about S. Africa which starts: "There was a time when S. African government officials treated foreigners with defensive courtesy; now the mood has changed to one of smooth assurance. The reason is plain; S. Africa as a whole is coming to believe that, however much the outside world disapproves of apartheid, the republic itself is invulnerable to outside pressures and need not fear them." The article then examines all the potential threats such as "internal rebellion," "boycotts," "Economic sanctions," and each threat is dispatched. It is obvious from the article that S. Africa is growing into a powerhouse of strength.

U. S. News & World Report (April 5) contains a report on S. Africa, part of which is reproduced at right. I leave it to my readers as to whether my original judgment on S. Africa was correct.

U.S. News & World Report JOHANNESBURG....PARIS....MOSCOW....LONDON....

>> From a "U.S. News & World Report" staff man on a swing around Africa:

"The white man is winning his battle to keep control of Southern Africa.

"Gone are the days when the white minority of South Africa, Rhodesia and Angola feared it would be overwhelmed by a black African revolution.

"Instead, whites in Southern Africa are growing stronger. Their African opponents are growing weaker. Black African politicians in countries to the north are squabbling among themselves, seem unable to agree on anything.

"In Southern Africa, itself, the African masses are weak, divided, tightly disciplined by the whites who continue to run things.

>> "What's more, white governments in Southern Africa are closing ranks. They are ignoring criticism from United Nations and elsewhere.

>> This report by our staff man in Africa concludes:

"As for South Africa, it is more than ever Africa's economic powerhouse.

"Economic upswing, in fourth year, is going very strong. Gross national product, adjusted for price changes, rose 7.5 per cent last year over the year before, and is still rising. Investment is up. Gold output is at a new high.

"All this increases odds against effective U.N. boycott of South Africa.

"There's very little overt racial trouble anywhere in Southern Africa at present. Potential for trouble of course remains. But as of now, at least, white minorities seem far ahead in their battle to retain control."

I judge that the many hundreds of my subscribers who now hold Kaffirs are interested in continuing news about S. Africa. This can be obtained (free) by writing to the Information Service of S. Africa (655 Madison Ave., N.Y.C. 21) and asking for the weekly Business Report. This report makes fascinating reading, and I have reprinted (second box below right) two of the items which caught my eye in this week's Report.

Two of the Kaffirs are acting particularly well, and despite the fact that I recommended both of them months ago at prices 20% under present levels, I continue to like them. Western Deep Levels, my number one choice, is discussed in the latest (March 11) issue of Standard & Poor's Foreign Securities Survey. S. & P states that Western Deep has "a life expectancy of about 60 years and is to become the world's largest and deepest gold mine." The figure of 60 years is an incredible one, and it points up the enormous reserves of this amazing mine. "Production started in 1962," continues S & P. "Results for 1964 showed gains of 6% in tons milled and 14% each in working profits and final net, giving 50¢ on the A and B stock combines .... A considerable expansion in profits is possible in 1965, with greater tonnage and higher grade ore expected to be mined. Moreover, a recent breakthrough in mining reportedly will increase tonnage substantially in coming years." Western Deep is a relatively new mine. The B shares sold as low as 5½ last year, they could have been purchased at 9½ at the end of 1964. They sold last week at an all-time high of 12. I believe they are still a buy at the market. (Dow Theory Letters holds a diversified position in Kaffirs including a position in Western Deep Levels A & B stock. More Western Deep was purchased by Dow Theory Letters last week).

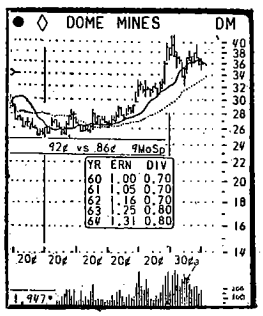
U.S. HAS FULL CONFIDENCE IN S.A. SAYS NORSTAD: General Norstad, retired NATO Supreme Commander and now a top American businessman, flew into Johannesburg last Saturday with a Ri-million ($1.4 million) investment blueprint - and a message of hope for South Africa. Mr. Harold Boeschenstein, Chairman of the biggest fibreglass manufacturing organization in the world, accompanied the 58-year old four star General. Their main interest is an expansion project for a fibre glass plant at Springs, Transvaal.

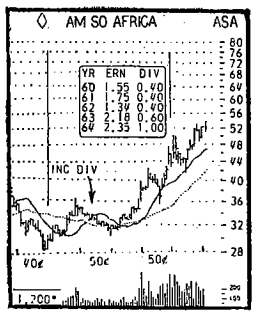
General Norstad, President of an international fibreglass concern and Mr. Boeschenstein expressed full confidence in South Africa's future. "We have full confidence in South Africa - not only we as individuals but the United States and the American people as well."

S.A. WELL SUPPLIED WITH ARMS: The Minister of Defense, Mr. J.J. Fouche, said yesterday that South Africa had the most effective field guns which had ever been bought in large quantities. The acquisition of these and other modern arms had been made possible by the excellent international co-operation which the South African Government enjoyed with many good friends overseas, said Mr. Fouche.

He said that at present South Africa had 120 licenses to manufacture various modern weapons locally - and in addition the Republic received all the blueprints to produce these arms. Mr. Fouche added that South Africa no longer had to go overseas to buy weapons. Instead Western Governments came to South Africa with offers to build arms factories in the Republic.

My second choice at this time: Free State Geduld, one of the world's lowest-cost gold producers. Selling at 21½ (recommended originally in Letter 270 at 17), this stock showed gains of 24% in working profits and 22% in final net for the year ending September, 1964. Free State earned $1.96 per share in 1964 (selling at 10 times earnings) and is paying a dividend of $1.33 (which may be raised this year). A blue-chip gold stock. If and when the institutions come into the Kaffirs, Western Deep and Free State are two issues they are sure to buy.





In Letter 279 I wrote: "I feel that Dome and the rest of the (Canadian) golds are probably now beginning to form new bases for the next move. American-South African reflects the greater value and strength of the S. African gold shares (which I recommend as buys now)." I stick by my observations in Letter 279. However, one singular phenomenon has crept into the picture. Historically, a short position in gold shares is very unusual. But look at this. Campbell; 4.7 thousand shorts in Oct., 5.1 in Nov., 6.1 in Dec., 15.0 in Jan., 14.3 in Feb., 17.4 in March! Dome; 1.3 in Dec., 5.8 in Jan., 8.4 in Feb., 13.4 in March! This is a real short build-up, and it is beginning to look like an explosive picture. If Dome and Campbell gain shorts in the latest (March-April) period, I believe it is going to point to gold fireworks ahead. As a rule, if a stock shows a steadily increasing short interest over a six month period without that stock breaking down, you can buy it for the "technical play" alone.

P & F chart of Baldwin-Lima courtesy of Chartcraft, Inc., Larchmont, New York.
Small weekly charts courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kansas.